EXHIBIT CE-8(B)

Annual Financial Statements of Knighthead Holdings Ltd. For 2018

Consolidated Financial Statements

Knighthead Holdings Ltd.
Years Ended December 31, 2018 and 2017
With Report of Independent Auditors

Ernst & Young Ltd.

Building a better working world

KNIGHTHEAD™

HOLDINGS LTD.

Consolidated Financial Statements

Knighthead Holdings Ltd.

Years Ended December 31, 2018 and 2017

Knighthead Holdings Ltd.

Consolidated Financial Statements

Years Ended December 31, 2018 and 2017

Contents

Building a better
working world

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Report of Independent Auditors

The Board of Directors
Knighthead Holdings Ltd.

We have audited the accompanying consolidated financial statements of Knighthead Holdings Ltd. (the Company), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Knighthead Holdings Ltd. at December 31, 2018 and 2017, and the consolidated results of its operations, changes in its shareholders' equity and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young Ltd.

March 19, 2019

Knighthead Holdings Ltd.

Consolidated Balance Sheets

(Expressed in United States Dollars)

	December 31	
	2018	**2017**
Assets		
Cash and cash equivalents	**$ 154,031,740**	$ 97,593,241
Investment securities, at fair value (cost – $252,124,237; 2017 – $228,774,606)	**267,159,110**	265,351,902
Derivative assets, at fair value (cost – $4,998,140; 2017 – $7,601,185)	**3,204,455**	4,941,038
Due from brokers	**86,309,256**	38,556,364
Interest and dividends receivable	**2,256,117**	1,439,510
Funds withheld at interest, at fair value	**486,499,278**	130,863,717
Premiums receivable	**842,000**	1,770,000
Deferred policy acquisition costs	**8,691,472**	4,941,771
Notes receivable	**10,000,000**	5,000,000
Other assets	**1,444,166**	869,288
Total assets	**$ 1,020,437,594**	$ 551,326,831
Liabilities		
Investment securities sold, at fair value (proceeds – $53,619,470; 2017 – $16,939,324)	**$ 52,555,840**	$ 17,945,935
Derivative liabilities, at fair value (cost – $2,419,429; 2017 – $784,694)	**1,740,558**	2,250,530
Due to brokers	**7,698,077**	8,419,945
Interest sensitive contract liabilities (portion at fair value – $423,939,319; 2017 – $123,808,915)	**701,605,453**	276,146,905
Future policy benefits	**474,882**	–
Accounts payable and accrued liabilities	**2,115,959**	6,858,674
Deferred tax liabilities	**562,408**	574,246
Interest paid in advance	**13,743,958**	397,010
Total liabilities	**780,497,135**	312,593,245
Shareholders' equity		
Share capital (par value $0.01; authorized, 50,000,000; issued and outstanding, 23,124,813)	**234,173**	233,769
Additional paid-in capital	**227,710,981**	226,966,295
Retained earnings	**11,370,789**	10,933,634
Shareholders' equity attributable to shareholders	**239,315,943**	238,133,698
Non-controlling interest in joint venture	**624,516**	599,888
Total equity	**239,940,459**	238,733,586
Total liabilities and equity	**$ 1,020,437,594**	$ 551,326,831

See accompanying notes.

Knighthead Holdings Ltd.

Consolidated Statements of Operations

(Expressed in United States Dollars)

	Year Ended December 31	
	2018	**2017**
Revenues		
Net investment income	**$ 18,396,847**	$ 33,981,119
Premiums earned	**500,000**	–
Fees and other income	**171,974**	74,771
Total revenues	**19,068,821**	34,055,890
Expenses		
Interest sensitive contract benefits[1]	**(719,280)**	6,781,506
Future policy and other policy benefits	**474,882**	–
Acquisition costs	**1,481,925**	760,470
Investment expenses	**3,441,852**	1,978,681
General and administrative expenses	**8,007,008**	6,190,252
Management fees	**5,965,184**	4,953,940
Performance fees	**–**	4,675,198
Total expenses	**18,651,571**	25,340,047
Income including non-controlling interest before income tax expense	**417,250**	8,715,843
Income tax benefit	**37,547**	382,831
Income including non-controlling interest	**454,797**	9,098,674
Income attributable to non-controlling interest in joint venture	**(17,642)**	(91,827)
Net income for the year	**$ 437,155**	$ 9,006,847

See accompanying notes.

[1]*Includes unrealized fair value gains and losses of interest sensitive contract liabilities at fair value (Refer to Note 8)*

Knighthead Holdings Ltd.

Consolidated Statements of Shareholders' Equity
(Expressed in United States Dollars)

	Year Ended December 31	
	2018	**2017**
Common shares issued and outstanding		
Balance, beginning of period	**23,084,400**	23,084,400
Issuance of common shares	**40,413**	–
Balance, end of period	**23,124,813**	23,084,400
Common shares		
Balance, beginning of period	**$ 233,769**	$ 233,769
Issuance of common shares	**404**	–
Balance, end of period	**234,173**	233,769
Additional paid-in capital		
Balance, beginning of period	**226,966,295**	226,782,763
Share compensation expense	**745,090**	183,532
Issuance of common shares	**(404)**	–
Balance, end of period	**227,710,981**	226,966,295
Retained earnings		
Balance, beginning of period	**10,933,634**	1,926,787
Income including non-controlling interest	**454,797**	9,098,674
Income attributable to non-controlling interest	**(17,642)**	(91,827)
Balance, end of period	**11,370,789**	10,933,634
Shareholders' equity attributable to shareholders	**239,315,943**	238,133,698
Non-controlling interest		
Balance, beginning of period	**599,888**	551,800
Non-controlling interest subscription to joint venture	**6,986**	–
Non-controlling interest withdrawal from joint venture	–	(43,739)
Income attributable to non-controlling interest	**17,642**	91,827
Balance, end of period	**624,516**	599,888
Total shareholders' equity	**$ 239,940,459**	$ 238,733,586

See accompanying notes.

Knighthead Holdings Ltd.

Consolidated Statements of Cash Flows
(Expressed in United States Dollars)

	Year Ended December 31	
	2018	**2017**
Operating activities		
Net income including non-controlling interest	**$ 454,797**	$ 9,098,674
Adjustments to reconcile net income to net cash used in operating activities:		
Share compensation expense	**745,090**	183,532
Interest sensitive contract benefits[2,3]	**5,625,094**	4,593,274
Net unrealized losses (gains) on investment securities	**19,474,522**	(7,341,690)
Net unrealized foreign exchange (gains) losses	**(1,517,125)**	442,131
Net realized investment gains	**(4,437,231)**	(8,783,501)
Depreciation and amortization of fixed assets	**206,381**	174,621
Net realized foreign exchange losses	**1,146,019**	1,341,444
Amortization of premium and accretion of discount, net	**(3,409,465)**	(6,143,366)
Other non-cash adjustments related to funds withheld agreements:		
Net investment income on funds withheld at interest	**(11,617,738)**	(2,790,416)
Interest sensitive contract benefits	**7,389,172**	1,840,145
Net change in fair value of reinsured liabilities	**(51,276,591)**	(6,104,531)
Net change in:		
Other assets	**(558,440)**	(77,604)
Interest and dividends receivable	**(816,607)**	1,027,339
Deferred policy acquisition costs	**(3,749,701)**	(2,591,801)
Premiums receivable	**928,000**	1,323,501
Future policy benefits	**465,474**	–
Accounts payable and accrued liabilities	**(4,735,729)**	828,627
Deferred tax liabilities	**(11,838)**	(382,831)
Interest paid in advance	**13,346,948**	397,010
Net cash used in operating activities	**(32,348,968)**	(12,965,442)

[2] *Comprised of impacts related to funds withheld coinsurance agreements*
[3] *Comprised of interest credited to policyholder account balances and changes in fair value of embedded derivatives associated with fixed indexed annuities.*

Knighthead Holdings Ltd.

Consolidated Statements of Cash Flows (continued)
(Expressed in United States Dollars)

	Year Ended December 31	
	2018	**2017**
Investing activities		
Purchase of investment securities	**$ (164,372,112)**	$ (230,355,269)
Proceeds from disposition of investments	**150,526,445**	212,233,965
Payments to cover securities sold short	**(50,384,547)**	(7,660,199)
Proceeds from securities sold short	**86,545,046**	11,382,411
Changes in net derivative contracts	**457,756**	(683,435)
Changes in due to/from brokers, net	**(48,474,760)**	(18,428,791)
Purchase of note receivable	**(5,000,000)**	(5,000,000)
Purchase of fixed assets	**(222,819)**	(158,484)
Net cash used in investing activities	**(30,924,991)**	(38,669,802)
Financing activities		
Policyholder account deposits	**123,193,693**	74,218,092
Policyholder account withdrawals	**(3,481,235)**	(1,882,920)
Net cash provided by financing activities	**119,712,458**	72,335,172
Net change in cash during the year	**56,438,499**	20,699,928
Cash, beginning of year	**97,593,241**	76,893,313
Cash, end of year	**$ 154,031,740**	$ 97,593,241
Supplementary information		
Non-cash transactions:		
Premiums and deposits on policies reinsured through funds withheld agreements	**$ 491,199,469**	$ 131,996,572
Claims and surrenders on policies reinsured through funds withheld agreements	**$ 4,700,191**	$ 1,132,855

See accompanying notes.

1. Organization and Basis of Presentation

Knighthead Holdings Ltd. (together with its wholly and majority owned subsidiaries, the "Company", "we", "us", or "our") was incorporated as an exempted company under the Companies Law of the Cayman Islands on January 2, 2014, and, through its wholly-owned subsidiary, Knighthead Annuity and Life Assurance Company ("Knighthead Annuity"), is a provider of U.S. and Canadian dollar denominated fixed rate annuity and life insurance products. Knighthead Annuity was incorporated in the Cayman Islands on July 25, 2014, and is licensed as a Class B(iii) insurer in accordance with the terms of The Insurance Law, 2010 and underlying regulations thereto (the "Law"), and is subject to regulation by the Cayman Islands Monetary Authority ("CIMA") in terms of the Law. Knighthead Annuity provides fixed annuity and life insurance products to an international client base, sold by regulated United States and global financial institutions.

On December 5, 2014, the Company and Knighthead Annuity entered into a Joint Venture and Investment Management Agreement with Knighthead Insurance Capital Management, LLC, which in turn engaged Knighthead Capital Management, LLC to perform the substantive investment advisory services (the "Investment Manager"), and Knighthead Insurance GP, LLC (the "General Partner"), a company that is not affiliated with the Company or Knighthead Annuity. The Joint Venture was created for the management of certain investable assets and to share in the profits and losses therefrom as provided in the agreement. Upon formation of the Joint Venture, Knighthead Annuity contributed $219,324,000 and the General Partner contributed $500,000 (see Note 14).

As of December 31, 2018, the Company wholly owned AP 2015 1, LLC, AP 2015 2, Inc., BH 2016-2, Kala Investments S.a.r.l., KALA TCIH, LLC, KH Smithers 2, LLC and Statler Ltd., which are investment holding companies.

These consolidated financial statements include the results of Knighthead Holdings Ltd. and its wholly and majority owned subsidiaries (defined as 100% or near 100%, and as described above), and have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). All significant intercompany accounts and transactions have been eliminated.

(Expressed in United States Dollars)

1. Organization and Basis of Presentation (continued)

The Company's business lines consist of both direct sales and reinsurance of fixed rate annuity and life insurance products. The Company's principal products are deferred annuities (including fixed indexed annuity ("FIA") contracts), immediate annuities and life insurance products.

Our reporting segments reflect the manner by which our chief operating decision makers view and manage the business. We currently distribute and service fixed rate annuities, including FIAs as well as reinsure annuities with similar product features from United States Cedants. Therefore, we have two reporting segments that our chief operating decision makers use to manage our business.

The following tables summarize the direct and reinsured premiums and annuity deposits by product type, which are not included as revenues (except for traditional premiums) in the accompanying Consolidated Statements of Operations, collected during the years ended December 31, 2018 and 2017:

	Year Ended December 31, 2018		
	Direct Issue	**Reinsured**	**Total**
Multi-year guaranteed annuities	**$ 102,772,025**	**$ 251,492,397**	**$ 354,264,422**
Fixed index annuities	**21,673,107**	**101,068,091**	**122,741,198**
Single premium immediate annuities	**1,080,000**	**–**	**1,080,000**
Total	**$ 125,525,132**	**$ 352,560,488**	**$ 478,085,620**

	Year Ended December 31, 2017		
	Direct Issue	**Reinsured**	**Total**
Multi-year guaranteed annuities	$ 52,251,769	$ 105,890,936	$ 158,142,705
Fixed index annuities	23,030,777	24,945,118	47,975,895
Single premium immediate annuities	470,000	–	470,000
Total	$ 75,752,546	$ 130,836,054	$ 206,588,600

1. Organization and Basis of Presentation (continued)

As of December 31, 2018, Kroll Bond rating Agency ("KBRA") and A.M. Best had issued credit ratings, financial strength ratings and/or outlook statements regarding us, as listed below. Credit ratings represent the opinions of rating agencies regarding an entity's ability to repay indebtedness. Financial strength ratings represent the opinions of rating agencies regarding the financial ability of an insurer or reinsurer to meet obligations under an insurance policy or reinsurance arrangement and generally involve quantitative and qualitative evaluations by rating agencies of a company's financial condition and operating performance. Generally, rating agencies base their financial strength ratings upon information furnished to them by the company and upon their own investigations, studies and assumptions. Financial strength ratings are based upon factors of concern to policyholders, agents, intermediaries and ceding companies and are not directed toward the protection of investors. Credit and financial strength ratings are not recommendations to buy, sell or hold securities or revoked at any time at the sole discretion of the rating organization.

	December 31, 2018	
	KBRA	**A.M. Best**
Financial strength rating	A-	B++
Outlook	Stable	Positive

Certain prior period amounts have been reclassified to conform to current period presentation.

2. Summary of Significant Accounting Policies

Revenue Recognition

Insurance Premiums

The Company's insurance premiums for traditional life insurance products are recognized as revenue when due from the policyholder. The Company's traditional life insurance products include those products with fixed premiums and benefits and consist primarily of certain annuities with life contingencies.

2. Summary of Significant Accounting Policies (continued)

Premium collections for indexed and fixed rate annuities (including multi-year guaranteed annuity ("MYGA") contracts, fixed indexed annuity ("FIA") contracts and single premium immediate annuity contracts without life contingencies ("SPIA")) are reported as deposit liabilities (i.e., interest sensitive contract liabilities) instead of as revenues. Similarly, cash payments to policyholders are reported as decreases in the liability for policyholder funds and not as expenses. Sources of revenues for products accounted for as deposit liabilities are net investment income (loss), surrender and other charges deducted from policyholder funds.

Net Investment Income (Loss)

Net investment income (loss) includes realized and unrealized gains and losses from the sales of investments, realized and unrealized gains and losses on derivative investments, interest and dividend income and expenses and realized and unrealized gains and losses on foreign exchange. Realized gains and losses on the sales of investments are determined using the specific identification method. Dividends are recorded on the ex-dividend date. Income and expense are recorded on the accrual basis including interest, premiums amortized and discounts accreted.

Use of Estimates

The preparation of the Company's consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The Company's significant estimates which are susceptible to change in the near term relate to fair value of certain invested assets and derivatives including embedded derivatives attributable to in-force FIA contracts. Actual results could differ from such estimates.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash held in banks and other short-term, highly liquid investments with original maturity dates of 90 days or less. At December 31, 2018, the Company held $78,262,740 (2017 – $Nil) cash equivalents.

(Expressed in United States Dollars)

2. Summary of Significant Accounting Policies (continued)

Other Assets

Other assets consist primarily of prepaid expenses and fixed assets. Fixed assets are recorded at cost when acquired and are depreciated using the straight-line method, over their estimated useful life, which is five years except for leasehold improvements. Leasehold improvements are amortized over the lesser of the estimated useful lives of the assets or remaining lease term. The carrying value of fixed assets is reviewed annually and any impairment in fair value will be charged to income during the period in which it occurs. At December 31, 2018 and 2017, the cost, accumulated depreciation and net carrying value of the fixed assets were as follows:

	December 31, 2018			**December 31, 2017**		
	Cost	**Accumulated Depreciation**	**Carrying Value**	**Cost**	**Accumulated Depreciation**	**Carrying Value**
Leasehold improvements	**$ 370,930**	**$ (259,898)**	**$ 111,032**	$ 370,930	$ (185,711)	$ 185,219
Computers and software	**617,933**	**(239,834)**	**378,099**	405,114	(139,373)	265,741
Office furniture	**158,667**	**(110,487)**	**48,180**	158,667	(78,754)	79,913
Total	**$ 1,147,530**	**$ (610,219)**	**$ 537,311**	$ 934,711	$ (403,838)	$ 530,873

Investments

The Company's investments are classified as "trading securities" and are carried at fair value with changes in fair value recorded within "Net investment income (loss)" in the consolidated statements of operations. The fair value of the Company's investments are based on quoted market prices, or when such prices are not available, by reference to broker or underwriter bid indications, industry recognized pricing vendors, and/or internal pricing valuation techniques. Investment transactions are recorded on a trade date basis with balances pending settlement included in due to/from brokers in the consolidated balance sheets. Realized gains and losses are determined using cost calculated on a specific identification basis. Dividends are recorded on the ex-dividend date. Income and expense are recorded on the accrual basis including interest and premiums amortized and discounts accreted.

2. Summary of Significant Accounting Policies (continued)

Derivative Contracts

Derivative instruments are recorded in the consolidated balance sheets at fair value, with changes in fair values and realized gains and losses recognized within "Net investment income (loss)" in the consolidated statements of operations.

The Company enters into derivative contracts to manage credit risk, interest rate risk, currency exchange risk, and other exposure risks including its exposure to product related equity market risk. The Company uses derivatives in connection with its risk-management activities to economically hedge certain risks and to gain exposure to certain investments. The utilization of derivative contracts also allows for an efficient means by which to trade certain asset classes. Fair values of derivatives are determined by using quoted market prices and counterparty quotes when available; otherwise fair values are based on pricing models that consider the time value of money, volatility, and the current market and contractual prices of underlying financial instruments.

Embedded Derivatives

We issue and reinsure annuity products, including both fixed and indexed annuity products. If we determine an embedded derivative has economic characteristics not clearly and closely related to the economic characteristics of the host contract, and a separate instrument with the same terms would qualify as a derivative instrument, the embedded derivative is bifurcated from the host contract and accounted for separately. Embedded derivatives are carried on the consolidated balance sheets at fair value in the same line item as the host contract. Changes in the fair value of embedded derivatives associated with fixed indexed annuities are reflected in interest sensitive contract benefits on the consolidated statements of operations. Embedded derivatives that are not clearly and closely related to the host contract within a financial asset are required to be bifurcated and recorded at fair value unless the fair value option is elected on the host contract. Under the fair value option, bifurcation of the embedded derivative is not necessary as all related gains and losses on the host contract and derivative will be reflected within net investment income on the consolidated statements of operations.

2. Summary of Significant Accounting Policies (continued)

Fixed indexed annuity contracts allow the policyholder to elect a fixed interest rate return or an equity market component where interest credited is based on the performance of common stock market indices. The equity market option is an embedded derivative, similar to a call option. The benefit reserve is equal to the sum of the fair value of the embedded derivative and the host (or guaranteed) component of the contracts. The fair value of the embedded derivative is computed as the present value of benefits attributable to the excess of the projected policy contract values over the projected minimum guaranteed contract values. The projections of policy contract values are based on assumptions for future policy growth, which include assumptions for expected index credits on the next policy anniversary date, future equity option costs, volatility, interest rates, and policyholder behavior. The projections of minimum guaranteed contract values include the same assumptions for policyholder behavior as were used to project policy contract values.

Reinsurance agreements written on a funds withheld coinsurance basis contain embedded derivatives. The fair value of the embedded derivatives on funds withheld is included in the funds withheld at interest line item on the consolidated balance sheets. The fair value of the embedded derivative is equal to the unrealized gain or loss on the underlying assets in the funds withheld trust and the fair value of stand-alone derivatives in the portfolios. The change in the fair value of the embedded derivatives related to the change in unrealized gain or loss is recorded in net investment income on the consolidated statements of operations.

Deferred Policy Acquisition Costs

The direct and incremental costs associated with the successful acquisition of fixed annuity and life insurance business; principally commissions, underwriting and other expenses are deferred and recorded in these consolidated financial statements as an asset referred to as deferred policy acquisition costs (“DAC”). DAC are subject to recoverability testing at the end of each accounting period. DAC is amortized through earnings over the expected life of the related policies using assumptions and estimates, including business mix of contract terms, lapse rates, partial and full withdrawals, mortality and other factors consistent with the Company’s proprietary model, supplemented as necessary with relevant industry experience. To the extent that actual experience differs from the assumptions and estimates used by the Company, adjustments will be recorded in the period they become known.

2. Summary of Significant Accounting Policies (continued)

Funds Withheld at Interest

Funds withheld at interest represents a receivable for amounts contractually withheld by ceding companies in accordance with reinsurance agreements in which we act as reinsurer or coinsurer. While the assets in funds withheld are legally owned by the ceding company, the assets are legally segregated from the general accounts of our cedants and all economic rights and obligations on the assets accrue to us. We periodically settle interest accruing to those assets at rates defined by the terms of the agreement. The underlying agreements contain embedded derivatives as discussed above, and as a result the carrying value of Funds Withheld at Interest is equal to the fair value of the underlying assets. The resulting impact on the statement of cash flows from funds withheld after non-cash activity is backed out is that the net cash interest settlements are included in operating activities. Any securities transfers as part of interest settlements, as well as deposits and withdrawals on the underlying agreements, are disclosed as non-cash items on the consolidated statement of cash flows. See additional information in Note 7 – Funds Withheld at Interest.

Notes Receivable

The notes receivable are carried at amortized cost and interest income is recognized over the term of the note using the simple interest method. The Company believes the notes receivable are fully collectible and therefore no allowance is required as of December 31, 2018.

Interest Sensitive Contract Liabilities

Interest sensitive investment-type contracts include fixed indexed and traditional fixed annuities in the accumulation phase and immediate annuities without significant mortality risk. We carry liabilities for fixed annuities at the account balances without reduction for potential surrender or withdrawal charges. The liability consists of the accumulated account values, which includes the contract purchase payment, plus interest credited, less policyholder withdrawals. The liabilities for FIAs consist of the value of the host contract plus the value of the embedded derivative. The embedded derivative is carried at fair value in "Interest sensitive contract liabilities" in the accompanying consolidated balance sheet with changes in fair value reported in the accompanying consolidated statement of operations. Liabilities for immediate annuities without life contingencies are carried at the present value of future benefits.

2. Summary of Significant Accounting Policies (continued)

Reinsurance

We assume insurance and investment contracts under coinsurance, funds withheld. We follow reinsurance accounting for transactions that provide indemnification against loss or liability relating to insurance risk (risk transfer). To meet risk transfer requirements, a reinsurance agreement must include insurance risk consisting of underwriting, investment and timing risk, and any other significant risks. Assumed premiums are included in the premiums line of the consolidated statements of operations.

For investment contracts, assets and liabilities assumed under coinsurance, funds withheld, are presented gross, at fair value, on the consolidated balance sheets. For insurance contracts, assets and liabilities assumed or ceded are presented gross on the consolidated balance sheets. The change in assumed reserves and benefits are presented net in the future policy and other policy benefits line on the consolidated statements of operations. Assumed premiums are included in the premiums line of the consolidated statements of operations.

Assets and liabilities assumed under funds withheld are presented gross, at fair value, on the consolidated balance sheets. The total return on funds withheld at interest is presented in net investment income on the consolidated statements of operations.

Accounting for reinsurance requires the use of assumptions upon agreement inception, particularly related to the future performance of the underlying business and the potential impact of counterparty credit risks. We attempt to minimize our counterparty credit risk through the structuring of the terms of our reinsurance agreements, including the use of trusts and segregated accounts, and we monitor credit ratings of counterparties for signs of declining credit quality. When a ceding company does not report information on a timely basis, we record accruals based on the best available information at the time, which includes the reinsurance agreement terms and historical experience. We periodically compare actual and anticipated experience to the assumptions used to establish reinsurance assets and liabilities.

2. Summary of Significant Accounting Policies (continued)

Share-Based Compensation

Knighthead Holdings has established a stock incentive plan for directors, employees and consultants of both Knighthead Holdings and its wholly owned subsidiary, Knighthead Annuity. The Company recognizes share-based compensation transactions using the fair value of the grant date of the award. Determining the fair value of share purchase options at the grant date requires significant estimation and judgment. The Company uses an option-pricing model (Black-Scholes) to calculate the estimated fair value of share purchase options. The Company's shares are not publicly traded; therefore, when estimating the expected volatility, the Company takes into consideration the historical volatility of similar publicly-traded entities. The Company uses the full life cycle of the options, in years, as the estimated term of the options, and has assumed no forfeitures and no dividends paid during the life of the options. The fair value of the awards is expensed over the performance or service period, which generally corresponds to the vesting period, and is recognized as an increase to "Additional paid-in capital" in "Stockholders' equity". Share-based compensation expense is reflected in "General and administrative expenses" on the consolidated statements of operations.

The Company measures compensation for restricted shares based on the price of the Company's common shares at the grant date and the expense is recognized on a straight-line basis over the vesting period. Actual results could differ from these estimates and assumptions, particularly in relation to the Company's estimation of volatility. As a result, share-based compensation expense could vary materially from the amounts provided in the consolidated financial statements. These estimates are regularly reviewed and, as new information becomes known, the expense is adjusted as necessary, in the period in which the adjustments are determined.

Foreign Exchange

The reporting and functional currency of the Company is the U.S. dollar. Transactions in foreign currencies are recorded in U.S. dollars at the exchange rates in effect on the transaction date. Monetary assets and liabilities in foreign currencies at the balance sheet date are translated at the exchange rate in effect at the balance sheet date and translation exchange gains and losses, if any, are included within "Net investment income (loss)" in the consolidated statements of operations. The Company does not isolate the portion of gains and losses on investments that is due to changes in foreign exchange rates from that which is due to changes in market prices of the investments. Such fluctuations are included within "Net investment income (loss)" in the consolidated statements of operations.

2. Summary of Significant Accounting Policies (continued)

Income Taxes and Uncertain Tax Positions

Knighthead Holdings Ltd. is domiciled in the Cayman Islands and its sole physical location is in the Cayman Islands. Under current Cayman Islands law, no corporate entity, including the Company and Knighthead Annuity & Life Assurance Company, is obligated to pay taxes in the Cayman Islands on either income or capital gains. The Company has an undertaking from the Governor-in-Cabinet of the Cayman Islands, pursuant to the provisions of the Tax Concessions Law, as amended, that, in the event that the Cayman Islands enacts any legislation that imposes tax on profits, income, gains or appreciations, or any tax in the nature of estate duty or inheritance tax, such tax will not be applicable to the Company, Knighthead Annuity & Life Assurance Company nor their respective operations, or to the ordinary shares or related obligations, until February 18, 2034.

The Company intends to operate in a manner so that it is not subject to U.S. tax and should not be treated as engaged in a trade or business within the United States. However, because there are no definitive standards provided by the Internal Revenue Service ("IRS"), regulations or court decisions as to the specific activities that constitute being engaged in the conduct of a trade or business within the United States, and as any such determination is essentially factual in nature, we cannot be certain that the IRS will not successfully assert that the Company is engaged in a trade or business within the U.S.

Deferred income tax assets and liabilities resulting from temporary differences between the GAAP and tax bases of assets and liabilities are measured at the balance sheet date using enacted income tax rates expected to apply to taxable income in the years the temporary differences are expected to reverse.

The Company offsets deferred income tax assets and liabilities for presentation in its consolidated financial statements when such assets and liabilities are within the same legal entity and related to the same taxing jurisdiction.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the Act). The Act introduces tax reform that reduces the current corporate federal income tax rate from 35% to 21%, among other changes. The corporate tax rate reduction is effective January 1, 2018, and the Company has determined that the Act required a revaluation of its deferred tax liability. The effect of the tax rate reduction for 2017 was a deferred tax benefit of $382,831.

2. Summary of Significant Accounting Policies (continued)

Future events such as changes in tax legislation could have an impact on the provision for income taxes and the effective income tax rate. Any such changes could significantly affect the amounts reported in the consolidated financial statements in the year these changes occur.

AP 2015 1, LLC was formed as a limited liability company on October 23, 2015, under the laws of the State of Delaware, USA. AP 2015 1, LLC is wholly owned by the Company and is thus treated as a disregarded entity for U.S. federal and state income tax purposes. As such, the Company, as the sole owner, will be responsible for any U.S. federal or state income taxes on the earnings of AP 2015 1, LLC.

AP 2015 2, Inc. conducts its affairs in a manner such that it should be treated as a corporation for U.S. federal and state income tax purposes. AP 2015 2, Inc. will file tax returns and pay income tax in the jurisdictions in which it conducts its affairs. AP 2015 2, Inc. recorded a deferred tax liability of $562,408 (2017 – $574,246) arising from unrealized gains on its investment in equity securities which is not subject to current period taxation by the IRS but is subject to estimated tax expense for the prior year operating period under US GAAP. AP 2015 2, Inc. recognized an income tax benefit of $37,547 for the year ended December 31, 2018 (2017 – $382,831).

BH 2016-2 and Statler, Ltd. are domiciled in the Cayman Islands. Under current laws of the Cayman Islands, there are no income, estate, sales or other Cayman Islands taxes payable by the corporation or withholding taxes that are applicable. U.S. federal income taxes may be withheld on certain income derived from U.S. sources.

Kala Investments S.a.r.l may be liable to pay income tax on certain income under the current laws and regulations in Luxembourg.

KH Smithers 2, LLC was formed as a limited liability company on February 27, 2017, under the laws of the State of Delaware, USA. KH Smithers 2, LLC conducts its affairs in a manner such that it should be treated as a corporation for U.S. federal and state income tax purposes. KH Smithers 2, LLC will file tax returns and pay income tax in the jurisdictions in which it conducts its affairs.

2. Summary of Significant Accounting Policies (continued)

KALA TCIH, LLC was formed as a limited liability company on February 27, 2017, under the laws of the State of Delaware, USA. KALA TCIH, LLC conducts its affairs in a manner such that it should be treated as a corporation for U.S. federal and state income tax purposes. KALA TCIH, LLC will file tax returns and pay income tax in the jurisdictions in which it conducts its affairs.

Any deferred tax asset is evaluated for recovery and a valuation allowance is recorded when it is more likely than not that the deferred tax asset will not be realized in the future. Management does not believe there are any tax positions taken by the Company that are subject to uncertainty and as a result, no provisions are made in these financial statements.

The Company reports interest and penalties, if any, in the consolidated statements of operations. For the years ended December 31, 2018 and 2017, no interest or penalties were recognized.

Non-Controlling Interest

Non-controlling interest in joint venture on the consolidated balance sheets represents the General Partner’s share of assets in the Joint Venture whereby the Investment Manager manages jointly held assets as disclosed in Note 3. The General Partner’s share of the Joint Venture’s investment income or loss is included in the consolidated statements of operations as income attributable to non-controlling interest in joint venture.

Leases

Leases in which substantially all of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are recognized in the consolidated statements of operations on a straight-line basis over the term of the lease.

Comprehensive Income (Loss)

The Company has no other comprehensive income (loss) other than the net income (loss) disclosed in the consolidated statements of operations.

2. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* ("ASU 2016-01"). The new guidance is intended to improve the recognition and measurement of financial instruments. ASU 2016-01, among other things, requires equity investments to be measured at fair value with changes in fair value recognized in net income or loss, requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset. ASU 2016-01 affects public and private companies, not-for-profit organizations, and employee benefit plans that hold financial assets or owe financial liabilities. The new guidance is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, ASU 2016-01 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company is currently evaluating the impact of this guidance on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* ("ASU 2016-02"). Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 is effective for public companies for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted for any organization in any interim or annual period. The Company currently has two operating leases for its office spaces as disclosed in Note 12 of the consolidated financial statements. The Company is in the process of evaluating the impact of adopting ASU 2016-02 on the Company's consolidated financial statements and anticipates implementing ASU 2016-02 during the first quarter of fiscal year 2019.

2. Summary of Significant Accounting Policies (continued)

In March 2016, the FASB issued ASU 2016-09, *Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting* ("ASU 2016-09"). ASU 2016-09 is intended to improve the accounting for employee share-based payments and affects all organizations that issue share-based payment awards to their employees. Several aspects of the accounting for share-based payment award transactions are simplified, including: (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statements of cash flows. The amendments are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any organization in any interim or annual period. This new accounting standard did not have a material impact on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurements of Credit Losses on Financial Instruments* ("ASU 2016-13"). ASU 2016-13 amends the guidance on reporting credit losses and affects loans, debt securities, trade receivables, reinsurance recoverables and other financial assets that have the contractual right to receive cash. The amendments are effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods. Early adoption is permitted for any organization for annual periods beginning after December 15, 2018, and interim periods within those annual periods. The Company is in the process of evaluating the impact of the requirements of ASU 2016-13 on the Company's consolidated financial statements and anticipates implementing ASU 2016-13 during the first quarter of fiscal year 2020.

In March 2017, the FASB issued Accounting Standards Update 2017-08, *Premium Amortization on Purchased Callable Debt Securities* ("ASU 2017-08"). ASU 2017-08 is intended to enhance the accounting for the amortization of premiums for purchased callable debt securities. The amendments are effective for interim and annual periods beginning after December 15, 2018. The Company is currently evaluating the impact of this guidance on the Company's consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, *Compensation – Stock Compensation – Scope of Modification Accounting* (Topic 718) ("ASU 2017-09"). ASU 2017-09 provides guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. ASU 2017-09 is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. This new accounting standard did not have a material impact on the Company's consolidated financial statements.

2. Summary of Significant Accounting Policies (continued)

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities* ("ASU 2017-12"). ASU 2017-12 guidance intends to better align an entity's risk management activities and financial reporting for hedging relationships through changes to the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2018. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU 2018-03, *Technical Corrections and Improvements to Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* ("ASU 2018-03"). The new guidance is intended to clarify certain aspects of the guidance issued in ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* ("ASU 2016-01"). ASU 2018-03, among other items, clarifies that the prospective transition approach for equity securities without a readily determinable fair value in the amendments in ASU 2016-01 is meant only for instances in which the measurement alternative is applied. ASU 2018-03 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company is currently evaluating the impact of this guidance on the Company's consolidated financial statements.

In July 2018, the FASB issued Accounting Standards Update 2018-10, *Codification Improvements to Topic 842, Leases* (ASU 2018-10) and Accounting Standards Update 2018-11, *Leases (Topic 842): Targeted improvements* (ASU 2018-11). These updates make improvements to clarify or to correct unintended application of guidance in ASC 842. Those items generally are not expected to have a significant effect on the Company. ASU 2018-10 and ASU 2018-11 will be effective when the Company adopts ASU 2016-02 in 2019.

2. Summary of Significant Accounting Policies (continued)

In August 2018, the FASB issued new guidance on long-duration insurance contracts (ASU 2018-12, *Financial Services–Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts).* The new guidance is effective for fiscal years beginning after December 15, 2021 and interim periods within those fiscal years. Early adoption is permitted. The new guidance (i) prescribes the discount rate to be used in measuring the liability for future policy benefits for traditional and limited payment long-duration contracts, and requires assumptions for those liability valuations to be updated after contract inception, (ii) requires more market-based product guarantees on certain separate account and other account balance long-duration contracts to be accounted for at fair value, (iii) simplifies the amortization of deferred policy acquisition costs ("DAC") for virtually all long-duration contracts, and (iv) introduces certain financial statement presentation requirements, as well as significant additional quantitative and qualitative disclosures. The Company is currently evaluating the impact of this guidance on the Company's consolidated financial statements.

In August 2018, the FASB issued Accounting Standards Update 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement* (ASU 2018-13). ASU 2018-13 is intended to improve the effectiveness of fair value measurement disclosure requirements. The amendments are effective for interim and annual periods beginning after December 15, 2019. The Company is currently evaluating the impact of this guidance on the Company's consolidated financial statements.

In October 2018, the FASB issued Accounting Standards Update 2018-17, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities* (ASU 2018-17). The amendments in ASU 2018-17 for determining whether a decision-making fee is a variable interest require reporting entities to consider indirect interests held through related parties under common control on a proportional basis rather than as the equivalent of a direct interest in its entirety. ASU 2018-17 is effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. This new pronouncement is not expected to have a material impact on the Company's consolidated financial statements.

(Expressed in United States Dollars)

3. Financial Instruments

The Company's investments are managed by the Investment Manager (Note 1) under a long-term investment management contract. The Company directly owns the investments, which are held by the Joint Venture in a Separate Account (the "Separate Account") and managed by the Investment Manager. The following is a summary of the Separate Account:

	December 31	
	2018	**2017**
Assets		
Cash and cash equivalents	**$ 141,728,969**	$ 96,023,642
Investment securities, at fair value	**253,117,193**	257,266,291
Derivative assets, at fair value	**2,341,312**	1,510,187
Due from brokers	**86,309,256**	38,556,365
Interest and dividends receivable	**2,256,117**	1,439,510
Prepaid expenses	**20,143**	34,096
Other assets	**595,924**	–
Total assets	**$ 486,368,914**	$ 394,830,091
Liabilities and non-controlling interest		
Investment securities sold, at fair value	**$ 52,555,840**	$ 17,945,935
Derivative liabilities, at fair value	**1,431,036**	435,774
Due to brokers	**7,698,077**	8,419,945
Deferred tax liabilities	**562,408**	574,246
Accounts payable and accrued liabilities	**755,518**	688,394
Withdrawals payable	–	5,220,825
Non-controlling interest	**624,516**	599,888
Total liabilities and non-controlling interest	**63,627,395**	33,885,007
Total net investments managed by Investment Manager	**$ 422,741,519**	$ 360,945,084

3. Financial Instruments (continued)

The Investment Manager establishes valuation processes and procedures to ensure that the valuation techniques for investments are fair, consistent, and verifiable. In the absence of observable market prices, the Company values its investments using valuation methodologies applied on a consistent basis. For some investments where little market activity may exist, management's determination of fair value is then based on the best information available. In certain circumstances the Investment Manager may incorporate management's own assumptions and exercise a significant degree of judgment, taking into consideration a combination of internal and external factors.

Investments for which market prices are not observable include investments in defaulted bonds of financial corporations, private notes and credit facilities. Such investments are valued on a monthly basis by taking into consideration any changes in key observable and unobservable inputs. Changes in economic and other relevant conditions are factored into valuation models and updated accordingly.

The Investment Manager designates a Valuation Committee (the "Committee") to oversee the entire valuation process of the Separate Account's investments. The Committee is comprised of the following personnel of the Investment Manager: a Managing Member, Chief Operations Officer, General Counsel and is chaired by the Chief Financial Officer. The Committee is assisted by representatives of the finance and accounting department of the Investment Manager. The Committee is responsible for developing the Separate Account's written valuation processes and procedures, conducting periodic reviews of the valuation policies, and evaluating the overall fairness and consistent application of the valuation policies. Valuations determined by the Committee are required to be supported by market data, third-party pricing sources, industry accepted pricing models, counterparty prices, or other methods the Committee deems to be appropriate, including the use of internal proprietary pricing models.

3. Financial Instruments (continued)

Fair Value Measurements

ASC 820 clarified the definition of fair value for financial reporting, established a framework for measuring fair value and required additional disclosures about the use of fair value measurements.

The hierarchy established under ASC 820 gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). As required by ASC 820, the Separate Account investments are classified within the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement. The three levels of the fair value hierarchy that prioritize inputs to valuation methods are as follows:

> Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
>
> Level 2 – Quoted prices for similar assets or liabilities in active markets, or quoted prices for identical assets or liabilities in inactive markets, or inputs that are observable, either directly or indirectly, for substantially the full term through corroboration with observable market data.
>
> Level 3 – Pricing inputs are unobservable for the asset or liability. That is, inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability.

Determination of Fair Value

In determining fair value, the Investment Manager uses various valuation approaches. Inputs that are used in determining fair value of an instrument may include price information, quotations received from market makers, brokers, dealers and/or counterparties (when available and considered reliable), credit data, volatility statistics and other factors. Inputs, including price information, may be provided by third-party pricing services or derived from market data; in addition, inputs can be either observable or unobservable. The following summarizes the fair value methodologies and associated inputs, which are particular to the specified security type and are in addition to the defined standard inputs to the valuation methodologies for all trading securities discussed above:

3. Financial Instruments (continued)

Equity Securities (Common and Preferred Stock)

Securities traded on a national securities exchange (or reported on the NASDAQ national market) are stated at the last reported sales price on the day of valuation. To the extent these securities are actively traded and valuation adjustments are not applied, they are categorized in Level 1 of the fair value hierarchy. Preferred stock and other equities traded on inactive markets or valued by reference to similar instruments are categorized in Level 2. While most equity securities are categorized in Level 1 or 2 of the fair value hierarchy, in instances where lower relative weight is placed on transaction prices, quotations, or similar observable inputs, they are categorized in Level 3.

Corporate Bonds

The fair value of corporate bonds is estimated using various techniques, which may consider recently executed transactions in securities of the issuer of comparable issuers, market price quotations (where observable) from either market maker/broker and/or third-party pricing services, bond spreads, fundamental data relating to the issuer, and credit default swap spreads adjusted for any basis difference between cash and derivative instruments. While most corporate bonds are categorized in Level 2 of the fair value hierarchy, in instances where lower relative weight is placed on transaction prices, quotations, or similar observable inputs, they are categorized in Level 3.

Bank Loans

Bank loans are valued based on pricing data received from a third-party pricing service and various broker quotes and is corroborated with observable market inputs. While most bank loans are categorized in Level 2 of the fair value hierarchy, in instances where lower relative weight is placed on transaction prices, quotations, or similar observable inputs, they are categorized in Level 3.

3. Financial Instruments (continued)

Derivative Instruments

Listed derivatives, such as exchange traded options, are valued based on quoted prices from the exchange and are categorized in Level 1 of the fair value hierarchy to the extent that these instruments are actively traded and valuation adjustments are not applied. Over-the-counter ("OTC") derivative contracts are privately negotiated contracts with counterparties including credit default swaps. Depending on the product and the terms of the transaction, the fair value for the OTC derivative products can be modeled taking into account the counterparties' creditworthiness and using a series of techniques, including simulation models. Many pricing models do not entail material subjectivity because the methodologies employed do not necessitate significant judgments and the pricing inputs are observed from actively quoted markets. Such contracts are categorized in Level 2. Those OTC derivatives that have less liquidity or for which inputs are unobservable are classified within Level 3. While the valuations of these less liquid OTC derivatives may utilize some Level 1 and/or Level 2 inputs, they also include other unobservable inputs, which are considered significant to the fair value determination.

Funds Valued at NAV

The Company values its investments in limited partnerships at fair value, which is estimated based on the Company's share of the NAV of the limited partnerships as provided by the investment managers of the underlying investment funds. The resulting net gains or net losses are reflected in the consolidated statements of income (loss). These investments are included in investment in funds valued at NAV and excluded from the presentation of investments categorized by the level of the fair value hierarchy. These investments are non-redeemable and distributions are made by the investment funds as underlying investments are monetized.

The Company has directly invested $12,352,158 in the Knighthead Special Situations Real Estate Fund II, LP. (the "SSRE Fund"), a fund vehicle managed by the Investment Manager. The SSRE Fund invests in first mortgages on real property. As of December 31, 2018, the Company had a remaining commitment of $2,647,842. The fair value is estimated based on the Company's share of the net asset value in the SSRE Fund, as provided by the Investment Manager, and was $14,041,917 as of December 31, 2018 (December 31, 2017 – $8,085,611). The resulting net gains or losses are reflected in the consolidated statements of operations.

(Expressed in United States Dollars)

3. Financial Instruments (continued)

The following table presents the financial instruments carried in the consolidated balance sheets by caption and by level within the valuation hierarchy as of December 31, 2018 and 2017:

	Fair Value as of December 31, 2018			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Bank loans	$ –	$ 68,708,270	$ 982,920	$ 69,691,190
Common stock	23,258,364	97,508	7,511,414	30,867,286
Corporate debt securities	943,903	93,849,204	4,520,227	99,313,334
Preferred stock	–	–	518,608	518,608
Non-U.S. government debt securities	–	11,356,011	–	11,356,011
Private equity	–	2,406,872	1,434,049	3,840,921
Trade claims	–	2,301,176	462,148	2,763,324
U.S. municipal securities	–	34,766,519	–	34,766,519
Total investment securities, at fair value	24,202,267	213,485,560	15,429,366	253,117,193
Commodity contracts	12,642	30,307	–	42,949
Credit contracts	–	629,813	–	629,813
Equity contracts	522,240	832,715	4,361	1,359,316
Foreign exchange contracts	–	139,682	–	139,682
Interest rate contracts	–	169,552	–	169,552
Index options	863,143	–	–	863,143
Total derivative assets, at fair value	1,398,025	1,802,069	4,361	3,204,455
Funds withheld at interest[4]	–	292,460,564	194,038,714	486,499,278
	$ 25,600,292	$ 507,748,193	$ 209,472,441	$ 742,820,926
Investment in fund valued at NAV				14,041,917
Total assets				$ 756,862,843
Liabilities				
Common stock	$ 19,638,639	$ –	$ –	$ 19,638,639
Corporate debt securities	–	7,952,970	–	7,952,970
U.S. government debt securities	–	2,106,773	–	2,106,773
Non-U.S. government debt securities	–	22,857,458	–	22,857,458
Total investment securities sold, at fair value	19,638,639	32,917,201	–	52,555,840
Credit contracts	–	555,592	–	555,592
Equity contracts	129,122	568,727	–	697,849
Foreign exchange contracts	–	177,595	–	177,595
Index options	309,522	–	–	309,522
Total derivative liabilities, at fair value	438,644	1,301,914	–	1,740,558
Interest sensitive contract liabilities	–	–	423,939,319	423,939,319
Total liabilities	$ 20,077,283	$ 34,219,115	$ 423,939,319	$ 478,235,717

[4] Comprised of host contract and embedded derivative of $7,036,464. The carrying value is equal to the fair value for both the host and embedded derivative. See Note 7 – Funds withheld at Interest for more detail.

(Expressed in United States Dollars)

3. Financial Instruments (continued)

	Fair Value as of December 31, 2017			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets				
Bank loans	$ –	$ 66,429,467	$ 1,229,660	$ 67,659,127
Common stock	50,413,646	5,461,879	10,445,743	66,321,268
Corporate debt securities	1,139,507	73,416,990	4,427,107	78,983,604
Equity securities	1,998,452	–	–	1,998,452
Non-U.S. government debt securities	–	27,417,579	–	27,417,579
Preferred securities	–	–	702,756	702,756
Private equity	–	–	708,105	708,105
Trade claims	–	10,404	21,503	31,907
U.S. municipal securities	–	13,443,493	–	13,443,493
Total investment securities, at fair value	53,551,605	186,179,812	17,534,874	257,266,291
Credit contracts	–	250,302	–	250,302
Equity contracts	199,364	48,817	13,446	261,627
Foreign exchange contracts	–	769,534	–	769,534
Interest rate contracts	–	228,724	–	228724
Index options	3,430,851	–	–	3,430,851
Total derivative assets, at fair value	3,630,215	1,297,377	13,446	4,941,038
Funds withheld at interest[5]	–	109,899,135	20,964,582	130,863,717
	$ 57,181,820	$ 297,376,324	$ 38,512,902	$ 393,071,046
Investment in fund valued at NAV				8,085,611
Total assets				$ 401,156,657
Liabilities				
Common stock	$ 8,909,649	$ –	$ –	$ 8,909,649
Corporate debt securities	–	3,602,133	–	3,602,133
Non-U.S. government debt securities	–	5,434,153	–	5,434,153
Total investment securities sold, at fair value	8,909,649	9,036,286	–	17,945,935
Credit contracts	–	352,208	–	352,208
Equity contracts	83,566	–	–	83,566
Index options	1,814,756	–	–	1,814,756
Total derivative liabilities, at fair value	1,898,322	352,208	–	2,250,530
Interest sensitive contract liabilities	–	–	123,808,915	123,808,915
Total liabilities	$ 10,807,971	$ 9,388,494	$ 123,808,915	$ 144,005,380

During the year ended December 31, 2018, the Company made no significant reclassifications of assets or liabilities between Levels 1 and 2.

[5] Comprised of host contract and embedded derivative of $137,693. The carrying value is equal to the fair value for both the host and embedded derivative. See Note 7 – Funds withheld at Interest for more detail.

(Expressed in United States Dollars)

3. Financial Instruments (continued)

The following table presents the reconciliation of all investments measured at fair value using significant unobservable inputs (Level 3) for the years ended December 31, 2018 and 2017:

	January 1, 2018	Transfers in to (out of) Level 3	Purchases	Sales and Settlements of Positions	Realized and Unrealized Gains (Losses)	December 31, 2018
Assets						
Bank loans	**$ 1,229,660**	**$ –**	**$ –**	**$ (72,570)**	**$ (174,170)**	**$ 982,920**
Common stock	**10,445,743**	**(2,532,390)**	**193,957**	**(358,878)**	**(237,018)**	**7,511,414**
Corporate debt	**4,427,107**	**347,173**	**1,133,688**	**(969,880)**	**(417,861)**	**4,520,227**
Equity contracts	**13,446**	**–**	**–**	**–**	**(9,085)**	**4,361**
Private equity	**708,105**	**–**	**481,928**	**–**	**244,016**	**1,434,049**
Preferred stock	**702,756**	**–**	**–**	**(235,919)**	**51,771**	**518,608**
Trade claims	**21,503**	**–**	**–**	**(3,542)**	**444,187**	**462,148**
Funds withheld at interest	**20,964,582**	**–**	**172,403,975**	**–**	**670,157**	**194,038,714**
Total assets	**$ 38,512,902**	**$ (2,185,217)**	**$ 174,213,548**	**$ (1,640,789)**	**$ 571,997**	**$ 209,472,441**
Liabilities						
Interest sensitive contract liabilities	**$ 123,808,915**	**$ –**	**$ 293,093,940**	**$ –**	**$ 7,036,464**	**$ 423,939,319**

	January 1, 2017	Transfers in to (out of) Level 3	Purchases	Sales and Settlements of Positions	Realized and Unrealized Gains (Losses)	December 31, 2017
Assets						
Bank loans	$ 760,756	$ –	$ 743,383	$ (530,000)	$ 255,521	$ 1,229,660
Common stock	5,594,775	–	5,403,623	(985,443)	432,788	10,445,743
Corporate debt	2,824,297	–	1,799,545	(929,045)	732,310	4,427,107
Equity contracts	4,438	–	11,503	–	(2,495)	13,446
Private equity	–	–	752,430	–	(44,325)	708,105
Preferred stock	547,512	–	–	–	155,244	702,756
Trade claims	51,574	–	–	(30,227)	156	21,503
Funds withheld at interest	–	–	19,955,360	–	1,009,222	20,964,582
Total assets	$ 9,783,352	$ –	$ 28,665,844	$ (2,474,715)	$ 2,538,421	$ 38,512,902
Liabilities						
Interest sensitive contract liabilities	$ –	$ –	$ 123,671,222	$ –	$ 137,693	$ 123,808,915

3. Financial Instruments (continued)

Additional Significant Unobservable Inputs

Significant unobservable inputs we use in the fixed indexed annuities embedded derivative of the interest sensitive contract liabilities valuation include:

1. Non-performance risk – For contracts reinsured through funds withheld reinsurance, the cedant company holds collateral against its exposure; therefore, such collateral mitigates the non-performance risk ascribed to these contracts.

2. Option budget – The Company assumes future hedge costs in the derivative's fair value estimate. The level of option budgets determines the future costs of the options and impacts future policyholder account value growth.

3. Policyholder behavior – We regularly review the lapse and withdrawal assumptions. These are based on the Company's initial pricing assumptions updated for actual experience. Actual experience may be limited for recently issued products.

Total unrealized gains related to fair value assets using significant unobservable inputs (Level 3) as of December 31, 2018, was $1,358,360 (2017 – $1,642,671). The transfers into and out of Level 3 were related to changes in the pricing source and changes in the observability of external information used in determining the fair value.

(Expressed in United States Dollars)

3. Financial Instruments (continued)

The following table summarizes information about the significant unobservable inputs used in determining the fair value of the Level 3 investments held by the Company.

	December 31, 2018			
	Fair Value	**Valuation Technique**	**Unobservable Input(s)**	**Range**
Assets				
Bank loans	$ 661,052	Broker quote	N/A	N/A
Bank loans	321,868	Discounted cash flow	Discount rate	9.00% – 11.20% (10.10%)
Common stock	5,389,369	Discounted cash flow	Discount rate	14.30%
Common stock	1,426,932	Net asset value	N/A	N/A
Common stock	559,091	Implied value	N/A	N/A
Common stock	117,000	Broker quote	N/A	N/A
Common stock	19,022	Guideline Public Company method	Marketability discount	25.00%
Preferred stock	518,608	Guideline Public Company method	Marketability discount	12.00% – 20.00% (17.60%)
Private equity	1,434,049	Net asset value	N/A	N/A
Corporate debt securities	1,506,725	Implied value	Recovery rate	65%
Corporate debt securities	1,163,819	Implied value	N/A	N/A
Corporate debt securities	1,124,596	Implied value	Marketability discount	10.00%
Corporate debt securities	725,087	Broker quote	N/A	N/A
Trade claims	444,200	Net asset value	Discount rate	19.40%
Trade claims	17,948	Implied value	N/A	N/A
Equity contracts	4,361	Guideline Public Company method	Marketability discount	25.00%
Funds withheld at interest	194,038,714	Amortized cost	N/A	100%
Interest sensitive contract liabilities	423,939,319	Net present value	Discount factors	43.30% – 99.67%

(Expressed in United States Dollars)

3. Financial Instruments (continued)

	December 31, 2017			
	Fair Value	**Valuation Technique**	**Unobservable Input(s)**	**Range**
Assets				
Bank loans	$ 886,494	Broker quotes	N/A	N/A
Bank loans	289,671	Discounted cash flow	Internal rate of return	13.00% – 17.00% (15.00%)
Bank loans	53,495	Implied value	N/A	N/A
Common stock	5,713,050	Broker quotes	N/A	N/A
Common stock	2,903,347	Implied value	N/A	N/A
Common stock	1,780,950	Net asset value	N/A	N/A
Common stock	48,396	Guideline Public Company method	Marketability discount	12.00% – 15.00% (17.98%)
Preferred stock	374,310	Recent transaction price	Private transaction	90
Preferred stock	328,446	Recent transaction price	Private transaction	142
Private equity	708,105	Net asset value	N/A	N/A
Corporate debt securities	2,258,571	Implied value	N/A	N/A
Corporate debt securities	2,146,094	Implied value	Recovery rate	27.40% – 40.00%
Corporate debt securities	22,442	Implied value	N/A	N/A
Trade claims	21,503	Recent transaction price	Private transaction	15.00%
Equity contracts	13,446	Guideline Public Company method	Marketability discount	25.00%
Funds withheld at interest	20,964,582	Amortized cost	N/A	100%
Interest sensitive contract liabilities	123,808,915	Net present value	Discount factors	45.11% – 99.77%

4. Due from/to Brokers

Due from/to brokers include net receivables and payables for unsettled trades, net unrealized gains and losses on foreign currency balances, cash and margin balances held at financial institutions. Margin balances are collateralized by certain Company investments and cash balances held by the financial institutions. In relation to margin debit balances, the Company is charged interest at fluctuating rates based on spreads around agreed reference rates. Certain investments are pledged to the financial institutions on terms that permit the financial institutions to sell or repledge the securities, subject to certain limitations. Cash and securities at the financial institutions that are related to securities sold and not yet purchased are partially restricted until the securities are purchased.

5. Investment Management Agreement

The Company incurs a share payment (the “Share Payment”), calculated in advance and payable in arrears of each fiscal quarter, equal to three hundred seventy-fifths of a thousand (0.375%) per fiscal quarter (i.e., one and one-half percent (1.50%) per annum) of the value of the capital account of the Company as of the opening of business on the first business day of each fiscal quarter, as defined in the Joint Venture and Investment Management Agreement (the “Agreement”).

Capital contributions received by the Company on a date other than on the first day of the fiscal quarter will be subject to a pro rata portion of the share payment, based upon the number of days outstanding in the relevant fiscal quarter. In the event that the Company withdraws all or a portion of its capital account on any date other than the last day of a fiscal quarter, the Company shall be charged a prorated portion of the Share Payment for the fiscal quarter, with respect to the number of days elapsed when such withdrawal was made.

In accordance with the provisions of the Agreement, net income or loss of the Joint Venture is allocated to all participants in proportion to their respective capital accounts as of the first day of a fiscal period, except as otherwise provided in the Agreement. Gains and losses arising from trading in securities that are classified as new issues under the rules of the Financial Industry Regulatory Authority are allocated to partners that are not restricted persons as defined in the Agreement.

Generally, at the end of each fiscal year, twenty percent (20%) of any net capital appreciation allocated to the capital account of any participant during such performance allocation calculation period will be reallocated to the capital account of the General Partner (the Performance Allocation); provided, however, that the net capital appreciation of which the Performance Allocation is based will be reduced to the extent of any “Loss Recovery Account” (as defined in the Agreement). The Performance Allocation is accrued on a monthly basis, taking into account the Loss Recovery Account during any period of accrual.

If the Company makes a withdrawal from its Capital Account, the General Partner is allocated twenty percent (20%) of any net capital appreciation allocated to the Capital Account of the Company; provided that any such amount shall be reduced to the extent that a Loss Recovery Account would have existed on such date. As of December 31, 2018 and 2017, there have been no withdrawals.

6. Derivative Contracts and Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk

In connection with its trading activities, the Company enters into transactions with a variety of securities and derivative financial instruments with multiple financial institutions. These trading activities may have market and/or credit risk in excess of the amounts recorded in the balance sheets.

The Company engages in short selling activities, wherein it borrows securities and sells them to third parties. Until the Company covers its short sales, it is exposed to market risk to the extent that subsequent market fluctuations may require purchasing securities sold, but not yet purchased, at prices that may be significantly higher than the fair value reflected in the financial statements. The Company's investments in securities and amounts due from broker are partially restricted until the Company satisfies the obligation to deliver the securities sold but not yet purchased.

The Company invests in corporate debt securities, bank loans, and other debt instruments. Until such investments are sold or mature, the Company is exposed to market and credit risk. Credit risk is the risk relating to whether the issuer will meet its obligation when it comes due. There is no clearinghouse for bank loans, nor is there a depository for custody of any such interests. The processes by which these interests are cleared, settled, and held in custody are individually negotiated between the parties to the transaction. This subjects the Company to operational risk to the extent that there are delays and/or failure in these processes. The Company may invest a portion of its assets in non-U.S. currencies or in instruments denominated in non-U.S. currencies, the prices of which are determined with reference to currencies other than the U.S. Dollar. The Company, however, values its securities and other assets in U.S. Dollars. The Company may or may not seek to hedge all or any portion of its foreign currency exposure. To the extent the Company's investments are not hedged, the value of the Company's assets will fluctuate with U.S. Dollar exchange rates as well as the price changes of the Company's investments in the various local markets and currencies.

In the normal course of business, the Company enters into transactions involving derivative financial instruments in connection with its investing activities. These instruments derive their value, primarily or partially, from the underlying asset, indices, reference rate, or combination of these factors. A derivative financial instrument may be traded on an exchange or over-the-counter ("OTC"). Exchange traded derivatives are standardized and include futures and certain options contracts. OTC derivatives are negotiated between contracting parties and include forwards, swaps, and certain option contracts.

6. Derivative Contracts and Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)

Derivative financial instruments are subject to various risks similar to non-derivative instruments, such as market risk and credit risk. Derivative financial instruments are typically also subject to certain additional risks, such as those resulting from leverage and reduced liquidity. The Company manages these risks on an aggregate basis along with the risks associated with its investing activities as part of its overall risk management policies. The Company may use derivative financial instruments in the normal course of its business to take speculative investment positions as well as for risk management purposes.

Market risk is the potential for changes in the value of derivative contracts and financial instruments from market changes, including fluctuations in securities prices. Market risk is directly affected by the volatility and liquidity in the markets in which the related instrument or underlying assets are traded. The Company manages its exposure to market risk related to trading instruments on an aggregate basis, combining the effects of cash instruments and derivative contracts.

Credit risk exists from the possibility of loss from the failure of a counterparty to perform according to the terms of a contract. At any moment, the credit risk for OTC derivative contracts is limited to the net unrealized gain, if any, as reported in the balance sheet for each counterparty for which a netting agreement exists. This netting basis is executed across products and cash collateral when these provisions are specified in the netting agreement.

The principal types of derivatives used by the Company for the years ended December 31, 2018 and 2017, as well as the methods in which they are used, are as follows:

Options

The Company uses options to reduce risk where the Company has exposure to a security. Options are contracts that grant the Company, in return for payment of the purchase price (the premium) of the option, the right to either purchase or sell a financial instrument at a specified price within a specified period of time or on a specified date, from or to the writer of the option. As a writer of a put or call option, the Company has no control over whether the option will be exercised and, as a result, bears the market risk of an unfavorable change in the price of the security underlying the written option. If the Company were to write a "naked" put or call option, a risk exists that the Company may not be able to enter into a closing transaction because of an illiquid market. When an option expires, the Company realizes a gain or loss on the option to the extent of the premiums received or paid.

6. Derivative Contracts and Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)

Fixed Index Annuity Contracts

The Company has FIA Contracts that permit the holder to receive an equity index linked component, where interest credited to the contracts is linked to the performance of either the S&P 500 Index, the MSCI EAFE index or the MSCI EM index. This feature represents an embedded derivative under U.S. GAAP. The FIA embedded derivative is valued at fair value and included in the liability for policyholder account balances in the accompanying Consolidated Balance Sheets with changes in fair value included as a component of "Interest credited to policyholder account balances" in the Consolidated Statements of Operations.

The Company purchases and sells derivatives consisting of call options on the S&P 500, MSCI EAFE and MSCI EM indices to fund the index credits due to FIA policyholders. The call options are one-year options purchased and sold to match the funding requirements of the underlying policies. On the respective anniversary dates of the index policies, the index used to compute the interest credit is reset and the Company purchases and sells new one-year call options to fund the next index credit. The Company manages the cost of these purchases through the terms of its FIA contracts, which permit the Company to change caps, spreads or participation rates, subject to guaranteed minimums, on each contract's anniversary date.

The change in the fair value of the call options contracts is generally designed to offset the portion of the change in the fair value of the FIA embedded derivative related to index performance. The call options are marked to fair value with the change in fair value included as a component of "Net investment income." The change in fair value of the call options contracts includes the gains and losses recognized at the expiration of the instrument term or upon early termination and the changes in fair value of open positions.

6. Derivative Contracts and Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)

Swaps

The Company may enter into swap agreements with counterparties, in which both parties agree to make periodic payments on a specified notional amount. The interest and financing payments are recorded in the statements of operations as realized gains or losses. Additionally, these swaps are marked-to-market on a daily basis and any change in value is recorded as unrealized appreciation (depreciation). When a swap is terminated, the Company will record realized gain or loss equal to the difference between the unwind proceeds and the Company's basis in the contract, if any. In order to enter into these swap agreements, the Company is required to make deposits or post collateral with its counterparties. As of December 31, 2018, collateral balances total $17,478,980. Swaps are subject to various risks, which include the possibility that there will be no liquid market for these agreements or that the counterparty in the agreement may default on its obligation to perform on its contractual terms. The Company reduces its credit risk for these over-the-counter swap contracts by negotiating master agreements that include netting provisions which incorporate the right of "set off" (assets less liabilities) across other OTC contracts with such counterparties.

On the consolidated balance sheets, the Company has elected not to offset fair value amounts recognized for cash collateral receivables against fair value amounts recognized for net derivative positions executed with the same counterparty under the same master netting arrangement. The Company invests in interest rate, credit default, and total return swaps.

Interest Rate Swaps

The Company is exposed to interest rate risk when there is an unfavorable change in the value of investments as a result of adverse movements in the market interest rates. The Company may enter into interest rate swap contracts to protect against such adverse movements in the interest rates. Interest rate swaps are contracts whereby counterparties exchange different rates of interest on a specified notional amount for a specified period of time. The payment flows are usually netted against each other, with the difference being paid by one party to the other.

6. Derivative Contracts and Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)

Credit Default Swaps

The Company uses credit default swaps to reduce risk where the Company has exposure to a referenced issuer (the "reference entity"), or to take an active long or short position based on the Company's view of the likelihood of an event of default affecting the reference entity. The reference entity underlying a credit default swap can be a single issuer, a portfolio or "basket" of issuers or an index. The underlying reference obligations are generally corporate debt. As with other OTC derivative contracts, credit default swaps involve greater risk than if the Company had invested in the reference obligation directly, including credit and liquidity risk in addition to market risk.

In a typical credit default swap, the Company enters into an OTC contract whereby the Company receives (if a buyer) or provides (if a seller) protection against certain credit events involving one or more specified reference entities. The buyer of a credit default swap is generally obligated to pay the seller a periodic stream of payments over the term of the contract in return for a contingent payment, typically the full notional amount of the credit default swap, upon the occurrence of an enumerated credit event. The applicable credit events are established at the inception of the transaction, and generally include bankruptcy, insolvency and failure to meet payment obligations when due, among other events. After a credit event occurs, the contingent payment payable by the seller to the buyer may be mitigated or reduced by segregated collateral and netting arrangements between the counterparties to the transaction.

The Company does not have third-party recourse in the case of default by the reference entity. As of December 31, 2018, the Company has not provided protection as a seller.

Total Return Swaps

The Company may enter into total return swap agreements. Total return swap agreements on an underlying reference asset (e.g., commodities, equities, or indices) involve commitments whereby cash flows are exchanged based on the price of an underlying reference asset and based on a fixed or variable rate. One party will receive payments based on the fair value of the underlying reference asset involved and pay a fixed amount.

6. Derivative Contracts and Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)

Total return swap agreements on indices involve commitments to pay interest in exchange for a market-linked return. One counterparty pays out the total return of a specific reference asset, which may be on equity, index, or bond, and in return receives a regular stream of payments. To the extent the total return of the security or index underlying the transaction exceeds or falls short of the offsetting interest rate obligation, the Company will receive a payment from or make a payment to the counterparty.

Futures

The Company may use futures contracts to gain exposure to, or hedge against, changes in the value of equities and commodities, interest rates or foreign currencies. A futures contract represents a commitment for the future purchase or sale of an asset at a specified price on a specified date. The purchase and sale of futures requires margin deposits with a Futures Commission Merchant ("FCM") equal to a certain percentage of the contract amount. Subsequent payments (variation margin) are made or received by the Company each day, depending on the daily fluctuations in the value of the contract. The Company recognizes a gain or loss equal to the daily variation margin. Futures may reduce the Company's exposure to counterparty risk since futures are exchange-traded and the exchange's clearinghouse, as the counterparty to all exchange traded futures, guarantees the futures against default.

The Commodity Exchange Act requires an FCM to segregate all customer transactions and assets from the FCM's proprietary activities. A customer's cash and other equity deposited with an FCM are considered commingled with all other customer funds subject to the FCM's segregation requirements. In the event of an FCM's insolvency, recovery may be limited to the Company's pro rata share of segregated customer funds available. It is possible that the recovery amount could be less than the total of cash and other equity deposited.

(Expressed in United States Dollars)

6. Derivative Contracts and Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)

Forwards

The Company enters into forwards to hedge itself against foreign currency exchange rate risk for its foreign currency denominated assets and liabilities due to adverse foreign currency fluctuations against the U.S. dollar.

Forward currency transactions are contracts or agreements for delayed delivery of specific currencies in which the seller agrees to make delivery at a specified future date of specified currencies. Risks associated with forward currency and commodity contracts are the inability of counterparties to meet the terms of their respective contracts and movements in fair value and exchange rates. The following table presents information on derivative assets and liabilities, all with U.S. Dollar as listing currency, which are shown gross on the balance sheets at December 31, 2018 and 2017:

	December 31, 2018			
	Derivative Assets* (Gross)		Derivative Liabilities* (Gross)	
	Location	**Fair Value**	**Location**	**Fair Value**
Credit swap contracts	Derivative assets	**$ 629,813**	Derivative liabilities	**$ 555,592**
Commodity contracts	Derivative assets	**42,949**	Derivative liabilities	–
Equity future contracts	Derivative assets	**832,715**	Derivative liabilities	**568,727**
Equity option contracts	Derivative assets	**522,240**	Derivative liabilities	**129,122**
Equity warrant contracts	Derivative assets	**4,361**	Derivative liabilities	–
Index options	Derivative assets	**863,143**	Derivative liabilities	**309,522**
Foreign exchange forwards	Derivative assets	**139,682**	Derivative liabilities	**177,595**
Interest rate swap contracts	Derivative assets	**169,552**	Derivative liabilities	–
FIA embedded derivatives		–	Interest sensitive contract liabilities	**553,622**
Total derivative contracts		**$ 3,204,455**		**$ 2,294,180**

(Expressed in United States Dollars)

6. Derivative Contracts and Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)

	December 31, 2017			
	Derivative Assets* (Gross)		Derivative Liabilities* (Gross)	
	Location	**Fair Value**	**Location**	**Fair Value**
Credit swap contracts	Derivative assets	$ 250,302	Derivative liabilities	$ 352,208
Equity future contracts	Derivative assets	48,817	Derivative liabilities	–
Equity option contracts	Derivative assets	199,364	Derivative liabilities	83,566
Equity warrant contracts	Derivative assets	13,446	Derivative liabilities	–
Index options	Derivative assets	3,430,851	Derivative liabilities	1,814,756
Foreign exchange forwards	Derivative assets	181,290	Derivative liabilities	–
Foreign exchange option contracts	Derivative assets	588,244	Derivative liabilities	–
Interest rate swap contracts	Derivative assets	228,724	Derivative liabilities	–
FIA embedded derivatives		–	Interest sensitive contract liabilities	1,616,094
Total derivative contracts		$ 4,941,038		$ 3,866,624

*No amounts were offset in the consolidated balance sheets

The following tables present realized and unrealized gains and losses on derivatives contracts, which are recorded in the following locations on the consolidated statements of operations for the year ended December 31, 2018 and 2017:

Gains (losses) recognized for the year ended December 31, 2018

	Location	**Net Realized Gains (Losses)**	**Location**	**Net Change in Unrealized Gains (Losses)**
Commodity option contracts	Net investment income	$ 891,570	Net investment income	$ (117,420)
Credit swap contracts	Net investment income	(358,440)	Net investment income	660,350
Credit option contracts	Net investment income	(13,960)	Net investment income	–
Equity future contracts	Net investment income	(269,271)	Net investment income	215,170
Equity option contracts	Net investment income	1,116,791	Net investment income	(101,158)
Equity warrant contracts	Net investment income	(4,419)	Net investment income	(9,085)
Index options	Net investment income	718,188	Net investment income	(1,975,352)
Foreign exchange forwards	Net investment income	(137,374)	Net investment income	(219,202)
Foreign exchange option contracts	Net investment income	(642,077)	Net investment income	216,829
Interest rate swap contracts	Net investment income	(680,823)	Net investment income	(59,172)
FIA embedded derivatives		–	Interest sensitive contract benefits	1,732,629
		$ 620,185		$ 343,589

(Expressed in United States Dollars)

6. Derivative Contracts and Financial Instruments with Off-Balance Sheet Risk and Concentration of Credit Risk (continued)

Gains (losses) recognized for the year ended December 31, 2017

	Location	Net Realized Gains (Losses)	Location	Net Change in Unrealized Gains (Losses)
Commodity future contracts	Net investment income	$ (763,277)	Net investment income	$ –
Commodity option contracts	Net investment income	(1,985,300)	Net investment income	–
Credit swap contracts	Net investment income	(2,459,958)	Net investment income	4,236
Credit option contracts	Net investment income	44,147	Net investment income	(35,011)
Equity future contracts	Net investment income	1,058,148	Net investment income	90,041
Equity option contracts	Net investment income	(2,508,390)	Net investment income	(181,029)
Equity warrant contracts	Net investment income	–	Net investment income	(2,495)
Index options	Net investment income	278,738	Net investment income	537,946
Foreign exchange forwards	Net investment income	(476,572)	Net investment income	(550,300)
Foreign exchange option contracts	Net investment income	(2,841,352)	Net investment income	611,740
Interest rate swap contracts	Net investment income	563,187	Net investment income	(392,893)
FIA embedded derivatives		–	Interest sensitive contract benefits	(388,242)
		$ (9,090,629)		$ (306,007)

7. Funds Withheld at Interest

Funds withheld at interest represents the receivable for assets supporting funds withheld reinsurance. These assets are held in trusts or custodial accounts that are legally segregated from our third-party ceding companies' general accounts and are managed by the Investment Manager. In the event of a ceding company's insolvency, we would need to assert a claim on the assets supporting our reserve liabilities. However, we have the ability to offset amounts we owe to the ceding company, which reduces our risk of loss. Interest generally accrues on these assets based upon the investment earnings on the underlying investments. The Company is subject to the investment performance and has all economic rights and obligations on the funds withheld assets in a fashion similar to invested assets held directly by the Company.

(Expressed in United States Dollars)

7. Funds Withheld at Interest (continued)

Information on the underlying assets within the funds withheld at interest is presented below.

	December 31	
	2018	**2017**
Cash and cash equivalents	**$ 47,775,085**	$ 33,752,668
Corporate debt securities	**214,955,693**	65,766,931
U.S. municipal securities	**1,823,168**	1,834,476
U.S. government and agencies	**1,016,272**	945,228
Direct mortgages and bank loans	**147,843,801**	4,829,311
Investment in funds valued at NAV	**46,194,913**	17,820,764
Premiums receivable and other assets	**26,890,346**	5,914,339
Total	**$ 486,499,278**	$130,863,717

8. Reserves

We use ASC 825 Fair Value Accounting authoritative guidance to determine the valuation of liabilities under reinsurance agreements for which the Company has elected fair value accounting. Accordingly, Interest Sensitive Contract Liabilities, at fair value, are determined by discounting expected future insurance cash flows using current market interest rates. The discounting convention used for determining such present value is a risk free curve, with an adjustment for own risk. Additionally, a liability is to be added to this present value to address uncertainty, which is called a risk margin liability. Interest Sensitive Contract Liabilities, at fair value, are subject to actuarial review on a regular basis and adjusted as new information becomes available and market rates change. If adjustments to the liability estimates are necessary they are reflected in the period in which they become known. Discount factors used in the net present valuation of amounts reinsured, at fair value as of December 31, 2018, ranged from 43.30% – 99.67% (2017 – 45.11% – 99.77%).

(Expressed in United States Dollars)

8. Reserves (continued)

The following tables summarize the movements in the interest sensitive contract liability reserves by line of business:

	December 31, 2018		
	Direct Issue	**Reinsured, at Fair Value**	**Total**
Balance, beginning of year	**$ 152,337,990**	**$ 123,808,915**	**$ 276,146,905**
Premiums collected	**123,193,693**	**352,560,488**	**475,754,181**
Insurance benefits and withdrawals	**(3,481,235)**	**(9,122,258)**	**(12,603,493)**
Interest credited	**5,615,686**	**–**	**5,615,686**
Unrealized gain – Change in risk free rate	**–**	**(26,548,854)**	**(26,548,854)**
Unrealized gain – Change in own risk spread	**–**	**(35,018,710)**	**(35,018,710)**
Unrealized loss – Change in risk margin	**–**	**15,365,570**	**15,365,570**
Accretion of discount	**–**	**2,894,168**	**2,894,168**
Balance, end of year	**$ 277,666,134**	**$ 423,939,319**	**$ 701,605,453**

	December 31, 2017		
	Direct Issue	**Reinsured, at Fair Value**	**Total**
Balance, beginning of year	$ 75,409,544	$ –	$ 75,409,544
Premiums collected	74,218,092	130,836,054	205,054,146
Insurance benefits and withdrawals	(1,882,920)	(1,933,571)	(3,816,491)
Interest credited	4,593,274	–	4,593,274
Unrealized gain – Change in risk free rate	–	10,309,720	10,309,720
Unrealized gain – Change in own risk spread	–	(18,043,139)	(18,043,139)
Unrealized loss – Change in risk margin	–	2,639,851	2,639,851
Accretion of discount	–	–	–
Balance, end of year	$ 152,337,990	$ 123,808,915	$ 276,146,905

9. Share Capital

The authorized share capital of the Company is $500,000 divided into 50,000,000 shares of a par value of US$0.01 each. The holders of all ordinary shares are entitled to share equally in dividends declared by the Board of Directors. In the event of a winding-up or dissolution of the Company, the ordinary shareholders share equally and ratably in the assets of the Company, after payment of all debts and liabilities of the Company and after liquidation of any issued and outstanding preferred shares.

(Expressed in United States Dollars)

9. Share Capital (continued)

The Amended and Restated Memorandum and Articles of Association (the “Articles”) provides that the holders of ordinary shares generally are entitled to one vote per share. If the votes conferred by the controlled shares of any person would otherwise cause such person or any other person to own, be deemed to own, or constructively own controlled shares that confer votes in excess of 9.9% of the votes conferred by all of the issued and outstanding shares, the votes with respect to such matter conferred by the shares of such person are reduced by whatever amount is necessary so that, after any such reduction, the votes conferred by the controlled shares of such person shall not result in such person or any other person controlling shares, which confer votes in excess of 9.9% of the votes conferred by all of the issued and outstanding shares.

No dividend was declared or paid during the years ended December 31, 2018 and 2017.

10. Net Investment Income

A summary of net investment income for the years ended December 31, 2018 and 2017, is as follows:

	Year Ended December 31	
	2018	**2017**
Net realized investment gains	**$ 4,437,231**	$ 8,779,883
Net change in unrealized (losses) gains on investments	**(18,804,365)**	8,259,741
Net realized foreign exchange losses	**(1,147,454)**	(1,341,444)
Net unrealized foreign exchange gains (losses)	**1,820,232**	(442,131)
Interest and dividend income	**31,477,587**	18,496,106
Other income	**613,616**	228,964
Net investment income	**$ 18,396,847**	$ 33,981,119

Investment returns are calculated monthly and compounded to calculate the annual returns. The resulting actual investment income may vary depending on cash flows into or out of the investment account.

11. Share-Based Compensation

Certain share-based compensation awards were approved by the Company's Board of Directors during the period pursuant to employee and director contracts and the Knighthead Holdings Ltd. Option Plan (the "Option Plan"). Such awards are made in the form of share options to purchase Shares of the Company. Additionally, the Company has recognized the expense related to restricted share awards granted in certain employee contracts where the performance criteria is achieved.

Share based compensation expense of $745,090 for the year ended December 31, 2018 (2017 – $183,532) was included in general and administrative expenses. As of December 31, 2018, the Company had $166,666 of unamortized share compensation expense, which is expected to be amortized over a weighted average period of 1.0 years.

Employee and Director Options

The options issued to employees under the Option Plan are subject to a service condition. On the date of grant, 25% of the options are vested and exercisable. On each of the following three anniversary dates following the grant date of the options, another 25% of the award will vest and become exercisable until the award is 100% vested. The director options vest and are exercisable on the grant date pursuant to the contractual conditions of their contracts. There were no forfeited options during the year ended December 31, 2018 (2017 – 5,200).

(Expressed in United States Dollars)

11. Share-Based Compensation (continued)

The employee and director share options activity for the year ended December 31, 2018 and 2017, were as follows:

	Number of Options	Weighted Average Exercise Price
Balance as of January 1, 2017	251,800	$ 15.00
Granted	–	–
Forfeited	(5,200)	–
Exercised	–	–
Balance as of December 31, 2017	246,600	
Granted – directors	30,000	14.70
Forfeited	–	–
Exercised	–	–
Balance as of December 31, 2018	276,600	

The fair value of share options issued were estimated on the grant date using the Black-Scholes option-pricing model. The estimated share price used for purposes of determining the fair value of share options that were granted in the period was $14.70. The volatility assumption used of 30.7% was based on the average estimated volatility of a select company peer group. The other assumptions used in the option-pricing model were as follows: risk free interest rate of 2.38%, expected life of 10 years and a 0% dividend yield. As of December 31, 2018, the weighted average remaining contractual term for options outstanding was 6.7 years. In 2018, there were 30,000 director options granted (2017 – Nil).

(Expressed in United States Dollars)

11. Share-Based Compensation (continued)

The following table summarizes information about the Company's share options outstanding as of December 31, 2018:

	Options Outstanding			Options Exercisable	
Exercise Price	**Number of Options**	**Weighted Average Exercise Price**	**Remaining Contractual Life**	**Number of Options**	**Weighted Average Exercise Price**
$15.00	246,600	$15.00	6.5	246,600	$15.00
$13.73-$15.48	30,000	14.70	8.0	30,000	14.70
	276,600	$14.97	6.7	276,600	$14.97

For the year ended December 31, 2018, the Company recorded $161,756 (2017 – $164,782) of share compensation expense related to share options. The aggregate intrinsic value of options outstanding and options exercisable as of December 31, 2018 was $Nil (2017 – $Nil).

Restricted Shares

Restricted shares vest at the end of the required two-year service period and contain certain restrictions during the vesting period, relating to, among other things, forfeiture in the event of termination of employment or service and transferability. Restricted share award activity for the year ended December 31, 2018, was as follows:

	Number of Non-Vested Restricted Shares	**Weighted Average Grant Date Fair Value**
Balance as of January 1, 2017	$ 10,000	$ 10.00
Forfeited	–	–
Vested	(10,000)	10.00
Balance as of December 31, 2017	–	
Granted	**72,743**	**10.31**
Vested	**(40,413)**	**10.31**
Balance as of December 31, 2018	**32,330**	

11. Share-Based Compensation (continued)

As of December 31, 2015, the Company issued 42,500 restricted shares to employees. The restricted shares issued to employees will cliff vest after two years from the date of issuance, subject to the grantee's continued service with the Company.

As of December 31, 2018, the Company issued 72,743 restricted shares to employees. On the date of grant, 40,413 of the restricted shares vested. Of the 32,330 unvested restricted shares issued to employees, 50% will vest on the first anniversary of the grant and the remaining 50% will vest on the second anniversary of the grant, subject to the grantee's continued service with the Company. No restricted shares were granted in 2017.

For the year ended December 31, 2018, the Company recorded $583,334 (2017 – $18,750) in compensation expense related to restricted share awards.

12. Commitments

Knighthead Annuity has leased office space in the Cayman Islands for a five-year term commencing April 15, 2015. The terms of the lease provide for the payment of annual rent, plus the payment of Knighthead Annuity's proportionate share of the landlord's operating and insurance costs. Knighthead Annuity has the option to renew the lease for a further five-year term upon expiry in 2020. As of December 31, 2018, Knighthead Annuity's estimated obligations under the terms of the lease are: $261,000 (2019); and $77,000 (2020).

13. Taxation

The Company provides for income tax expense or benefit based upon pre-tax income or loss reported in the consolidated financial statements and the provisions of currently enacted tax laws.

Knighthead Holdings Ltd. is domiciled in the Cayman Islands and its sole physical location is in the Cayman Islands. Under current Cayman Islands Law, no corporate entity, including the Company, is obligated to pay taxes in the Cayman Islands on either income or capital gains. The Company intends to operate in a manner so that it is not subject to U.S. tax and should not be treated as engaged in a trade or business within the United States. However, because there are no definitive standards provided by the Internal Revenue Service ("IRS"), regulations or court decisions as to the specific activities that constitute being engaged in the conduct of a trade or business within the United States, and as any such determination is essentially factual in nature, we cannot be certain that the IRS will not successfully assert that the Company is engaged in a trade or business within the U.S.

AP 2015 1, LLC was formed as a limited liability company on October 23, 2015, under the laws of the State of Delaware, USA. AP 2015 1, LLC is wholly owned by the Company and is thus treated as a disregarded entity for U.S. federal and state income tax purposes. As such, the Company, as the sole owner, will be responsible for any U.S. federal or state income taxes on the earnings of AP 2015 1, LLC.

AP 2015 2, Inc. conducts its affairs in a manner such that it should be treated as a corporation for U.S. federal and state income tax purposes. AP 2015 2, Inc. will file tax returns and pay income tax in the jurisdictions in which it conducts its affairs. AP 2015 2, Inc. recorded a deferred tax liability of $562,408 (2017 – $574,246) arising from unrealized gains on its investment in equity securities which is not subject to current period taxation by the IRS but is subject to estimated tax expense for the current period under US GAAP. AP 2015 2, Inc. recognized a provision for income tax benefit of $37,547 for the year ended December 31, 2018 (2017 – $382,831).

Statler, Ltd. and BH 2017-2 are domiciled in the Cayman Islands. Under current laws of the Cayman Islands, there are no income, estate, sales or other Cayman Islands taxes payable by the corporation or withholding taxes that are applicable. U.S. federal income taxes may be withheld on certain income derived from U.S. sources.

Kala Investments S.a.r.l may be liable to pay income tax on certain income under the current laws and regulations in Luxembourg.

(Expressed in United States Dollars)

13. Taxation (continued)

KH Smithers 2, LLC was formed as a limited liability company on February 27, 2017, under the laws of the State of Delaware, USA. KH Smithers 2, LLC conducts its affairs in a manner such that it should be treated as a corporation for U.S. federal and state income tax purposes. KH Smithers 2, LLC will file tax returns and pay income tax in the jurisdictions in which it conducts its affairs.

KALA TCIH, LLC was formed as a limited liability company on February 27, 2017, under the laws of the State of Delaware, USA. KALA TCIH, LLC conducts its affairs in a manner such that it should be treated as a corporation for U.S. federal and state income tax purposes. KALA TCIH, LLC will file tax returns and pay income tax in the jurisdictions in which it conducts its affairs.

The following table sets forth our current and deferred income tax (benefit) expense on a consolidated basis for the years ended December 31, 2018 and 2017:

	2018	**2017**
Current tax expense	**$ 5,856**	$ –
Deferred tax (benefit) expense	**(43,403)**	(382,831)
	$ (37,547)	$ (382,831)

The following table presents a reconciliation of expected income taxes to income tax (benefit) expense for the years ended December 31, 2018 and 2017:

	2018	**2017**
Cayman (expected tax expense at 0%)	**$ –**	$ –
United States	**(37,547)**	(382,831)
Income tax (benefit) expense	**$ (37,547)**	$ (382,831)

The deferred tax liabilities of $562,408 as of December 31, 2018 (2017 – $574,246) related to U.S. income tax and are accrued for unrealized gains on investments. Deferred tax benefits for AP 2015 2, Inc. for the year ended December 31, 2018, of $37,547 resulted from the change in the unrealized gains on investments. The Company has not taken any tax positions that are subject to uncertainty or that are reasonably likely to have a material impact to the Company.

(Expressed in United States Dollars)

14. Non-Controlling Interest

Non-controlling interest represents the portion of equity in the consolidated subsidiary not attributable, directly or indirectly, to the Company. The ownership interest in consolidated subsidiary held by parties other than the Company have been presented in the consolidated balance sheets, as a separate component of shareholders' equity.

Non-controlling interests as of December 31, 2018 and 2017, are as follows:

	December 31	
	2018	**2017**
Joint Venture – Knighthead Insurance GP, LLC share	**$ 624,516**	$ 599,888

The Joint Venture created through the Investment Management Agreement (Note 5) has been considered a variable interest entity in accordance with U.S. GAAP. Since the Company was deemed to be the primary beneficiary, the Company has consolidated the Joint Venture and has recorded Knighthead Insurance GP, LLC's minority interest as a non-controlling interest in the consolidated statements of shareholders' equity. For the years ended December 31, 2018 and 2017, there were no distributions by Knighthead Insurance GP, LLC from its interest in the Joint Venture.

15. Note Receivable

On September 25, 2017, the Company entered into a transaction with a ceding company to hold a note receivable of $5,000,000. The scheduled maturity date of the note is June 25, 2032. Subject to the approval of the domiciliary state insurance commissioner of the issuing entity, the Company will receive interest thereon, quarterly, in arrears commencing on December 1, 2017, at the rate of 6.75% per annum. For the year ended December 31, 2018, the Company received $337,500 (2017 – $59,178) in interest income on the note.

On May 31, 2018, the Company entered into a transaction with a ceding company to hold a note receivable of $5,000,000. The scheduled maturity date of the note is June 25, 2032. Subject to the approval of the domiciliary state insurance commissioner of the issuing entity, the Company will receive interest thereon, quarterly, in arrears commencing on September 1, 2018, at the rate of 6.75% per annum. For the year ended December 31, 2018, the Company received $163,665 in interest income on the note.

16. Pension Arrangements

Knighthead Annuity contributes to a mandatory defined contribution pension plan for the provision of employee retirement benefits. Contributions are made by the Knighthead Annuity and these contributions are supplemented by the individual plan participants. Contributions are based on a percentage of the participants' base salary, the benefits of which vest immediately to the employee. Employer contributions were $131,840 for the year ended December 31, 2018 (2017 – $98,488).

17. Statutory Reporting

Under the terms of its Class B (iii) insurance license, Knighthead Annuity, a wholly-owned subsidiary of the Company, is in the business of accepting risks by effecting or carrying out contracts of insurance. In accordance with the definition under the Law, Knighthead Annuity is a long-term insurer. As defined by Law, Knighthead Annuity's fixed annuity products are "long-term business" whereby it issues "contracts of insurance on human life or contracts to pay annuities on human life, including linked policies." Accordingly, Knighthead Annuity shall report in its annual statutory financial returns the proceeds of its insurance contracts as insurance revenue, with the respective policy holder liabilities of the contracts in-force reported as insurance reserves. Knighthead Annuity is required to maintain a prescribed margin of solvency in accordance with the Law.

18. Subsequent Events

Subsequent events were evaluated to March 19, 2019, the date the financial statements were available to be issued.